Supreme Court, U. S.
FILED
OCT 21 1976
MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1976

No. 76-272

FEDERAL DEPOSIT INSURANCE CORPORATION, as successor in interest to Franklin National Bank,
Petitioner,
v.
ISRAEL-BRITISH BANK (LONDON) LIMITED, Bankrupt,
Respondent,
and
BANK OF THE COMMONWEALTH,
Respondent.

No. 76-271

BANK OF THE COMMONWEALTH,
Petitioner,
v.
ISRAEL-BRITISH BANK (LONDON) LIMITED, Bankrupt,
Respondent,
and
FEDERAL DEPOSIT INSURANCE CORPORATION, as successor in interest to Franklin National Bank,
Respondent.

REPLY BRIEF OF PETITIONERS FEDERAL DEPOSIT INSURANCE CORPORATION AND BANK OF THE COMMONWEALTH

JOHN J. WALSH
EARL H. NEMSER
Attorneys for Petitioner
Federal Deposit Insurance
Corporation

Of Counsel:
C[illegible]WALADER, WICKERSHAM & TAFT

ARTHUR H. SCHWARTZ
Attorney for Petitioner
Bank of the Commonwealth

Of Counsel:
HERBERT P. JACOBY
BURNS & JACOBY

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Petitioners Federal Deposit Insurance Corporation and Bank of the Commonwealth respectfully submit this reply brief addressed particularly to certain arguments first raised by Respondent in its brief in opposition to the companion petitions.

1. THE PRINCIPLE OF FEDERALISM

Respondent appears to argue that the principle of federalism has been overlooked by Petitioners and somehow overlooked by the Court in its decisions in *Clark* v. *Williard,* 294 U.S. 211 (1935) and 292 U.S. 112 (1934). (IBB at 15).* Rather than "elide" that principle as it finds expression in the Bankruptcy Act ("Act"), as Respondent suggests, the Court in *Clark* v. *Williard* expressly noted that Congress apportioned jurisdiction between the federal government and the states:

> "[I]nsurance corporations, *like banks,* are excluded from bankruptcy altogether (11 U.S.C. § 22b), and must submit to dismemberment, however great the waste or inequality, unless receivers are appointed." 292 U. S. at 123-124. (Emphasis added.)

In *Clark* the Court had indicated that each state is the "ultimate authority" with respect to local property of excluded entities, although most states give priority to a duly appointed liquidator. *Id.* at 123.

In terms of federalism, the question presented is whether New York law or the federal Act will determine if attaching creditors are to be preferred over Respondent's official liquidator (representing its creditors world-wide) with respect to local property? Put another way, may New York determine whether to protect the interests of local creditors?

If the states through their representatives in Congress applied the principle of federalism to reserve authority over local property of domestic banks or insurance companies, one may ask whether there was any reason to relinquish such authority over local property of foreign banks or insurance companies? Respondent suggests no

*References to Respondent's brief are designated (IBB) followed by the appropriate page number.

reason. Yet the burden of persuasion clearly rests upon it in view of the generic exclusionary language adopted by Congress in Section 4 of the Act.

We submit that Respondent, having that burden, has relied, as did the Second Circuit, on a misconception of the principle of federalism for a quick resolution of the issue presented. Professor Herbert Wechsler observed on this very point:

> "National power may be quite unquestioned in a given situation; those who would advocate its exercise must none the less answer the preliminary question why the matter should not be left to the states. Even when Congress acts, its tendency has been to frame enactments on an *ad hoc* basis to accomplish limited objectives, supplanting state-created norms only so far as may be necessary for the purpose.*** As Henry Hart and I have put it elsewhere: 'Congress acts . . . against the background of the total *corpus juris* of the states in much the way that a state legislature acts against the background of the common law, assumed to govern unless changed by legislation.' As a state legislature views the common law as something to be left alone unless a need for change has been established, so Congress has traditionally viewed the governance of matters by the states.
>
> *The tradition plainly serves the values of our federalism insofar as it maintains a burden of persuasion on those favoring national intervention."*
>
> Wechsler, *The Political Safeguards Of Federalism: **The Role Of The States In the Composition And Selection Of The National Government,*** 54 Colum. L. Rev. 543, 545 (1954). (Emphasis added.)

Neither Respondent nor the Second Circuit remotely suggest that this important burden has been met.

Respondent's puzzling reliance on federalism hardly answers the question—rather it underscores the delicate nature of the issue of federal-state relationships.

Should the judiciary by novel interpretation and negative inference occupy a field which Congress reserved for the states and through the mechanism of the Bankruptcy Act regulate the liquidation of the local property of a foreign banking corporation (or insurance or railroad corporation); or should this field be preserved for the states by the judiciary until the representatives in Congress elected from the states relinquish it by clearly and expressly placing it in the federal sphere?

For some reason the court below presumed that the states are not competent to deal equitably with local assets of a foreign bank, although they admittedly can administer the local assets of a sister state domestic bank. But the states have proven competent and if their represenatives in Congress appear to have expressly retained this authority, the judiciary is without power to make a superseding judgment. As Professor Henry Hart noted:

> "In wide areas, accordingly, a state law continues to operate not by virtue of the Tenth Amendment but by virtue only of the non-exercise of latent federal powers, furnishing impressive evidence of the practical worth of the state governments." Hart, *The Relations Between State And Federal Law,* 54 Colum. L. Rev. 489, 526 (1954).

Respondent does not urge judicial interpretation to expand federal jurisdiction into an unregulated field. This is a case where state law otherwise controls and, in the absence of a contrary decision, for the last three-quarters of a century such control has been unquestioned. Accordingly, the decision below diminishes the states' authority to administer property within their borders and determine whether and how to protect the rights of local creditors engaged in business dealings with foreign entities. Nor have the states taken this authority lightly as evidenced

by the expanding breadth of *quasi in rem* jurisdiction and state long-arm statutes.

When viewed against the considerations Respondent urges, the issue presented is one for the Congress, not the courts. Consequently, the judicial expansion of federal jurisdiction which Respondent would have this Court leave unexamined will have a corrosive effect on the principles of federalism, judicial restraint and—most importantly—separation of powers.

II. THE IMPORTANCE OF THE ISSUE

The effect of the decision below is not limited to a narrow, academic or episodic set of facts as Respondent *now* would have this Court believe.* Since the *same* operative language appears in Section 4 of the Bankruptcy Act regarding banking, insurance and railroad corporations, the result in this case will govern whether such foreign entities are subject to voluntary and involuntary proceedings under the Act, including proceedings under Chapters X and XI. Accordingly, the question concerns every such entity outside the United States world-wide which has assets in the United States and each such entity's creditors;

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*It is indeed the rare case where all parties to a Petition for Certiorari insist that the question presented is of sufficient importance to deserve the attention of the Court. In this regard it is significant to note that before Respondent took the about-face expressed in its opposition, it opened its brief below with the following language:

> "The court below recognized that the issue presented by this appeal is one of first impression and is of great significance to the international banking community. The *same* issue has been presented in [*Bankhaus I.D. Herstatt*] an involuntary bankruptcy petition; [*Banque de Financement*] a Chapter XI proceeding; and [*Israel-British Bank Limited*, the Israeli parent of Respondent] an involuntary bankruptcy petition * * *." (Emphasis added.)

it will subject all such assets to administration in federal bankruptcy proceedings.

In an attempt to minimize the significance of the issue presented, Respondent stresses that to date "only four cases of unregulated foreign banks have surfaced." (IBB at 7). Yet it fails to disclose that all four of such cases arose within a few months of one another during the 1974-75 recession. That circumstance tends to demonstrate that for many decades the proposition that the exclusionary language of Section 4 of the Act meant exactly what it said had been uniformly recognized. Now that the Second Circuit has ruled to the contrary, the likelihood that the next ill wind that blows will be followed by another spate of similar proceedings—voluntary and involuntary—has been infinitely multiplied. The recurring nature of the question, absent reversal, will be limited only by the recurring nature of economic crises around the world.

Petitioners Federal Deposit Insurance Corporation and Bank of the Commonwealth urge the Court to consider the question presented now rather than permit another economic downswing to set the stage for new litigation involving these issues.

Nor should the fact that other circuits have not considered the question presented diminish the need for prompt review. As Respondent indicates, the Second Circuit presides over "the commercial and banking center of the United States." (IBB at 8). Therefore, on those occasions

when that court is incorrect in an area of national—and international—economic importance, it is incumbent on this Court to correct it.

Respectfully submitted,

JOHN J. WALSH
EARL H. NEMSER
Attorneys for Petitioner
Federal Deposit Insurance Corporation

Of Counsel:
CADWALADER, WICKERSHAM & TAFT

ARTHUR H. SCHWARTZ
Attorney for Petitioner
Bank of the Commonwealth

Of Counsel:
HERBERT P. JACOBY
BURNS & JACOBY

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